

Bulletin No. 221

FEDERAL RESERVE BANK OF CHICAGO

230 SOUTH LA SALLE STREET

August 1, 1932.

SUBJECT: DISCOUNTS FOR INDIVIDUALS, PARTNERSHIPS AND CORPORATIONS.

**To all Banks and Trust Companies
in the Seventh Federal Reserve District:**

An amendment to the Federal Reserve Act recently passed by Congress authorizes Federal reserve banks in certain cases involving unusual and exigent circumstances to discount for individuals, partnerships or corporations, notes, drafts, and bills of exchange of the kinds and maturities heretofore eligible for discount for member banks only, when such paper is endorsed and otherwise secured to the satisfaction of the Federal reserve bank.

For your information, we present on the following two pages copy of the Federal Reserve Board's circular which contains the full text of the amendment, and information in detail relating to the requirements and procedure to be followed in making the amendment effective. The fourth page hereof contains extracts from Regulation "A" of the Federal Reserve Board, describing in general terms the character of paper eligible for discount by Federal reserve banks.

It will be observed that the credit facilities provided under the amended act are available only in instances where the applicant cannot obtain adequate credit accommodations from other banking institutions.

JAMES B. McDOUGAL,
Governor.

FEDERAL RESERVE BOARD

WASHINGTON

July 26, 1932.

SUBJECT: DISCOUNTS FOR INDIVIDUALS, PARTNERSHIPS AND CORPORATIONS.

To All Federal Reserve Banks:

The third paragraph of Section 13 of the Federal Reserve Act, as amended by the Act of July 21, 1932, provides as follows:

"In unusual and exigent circumstances, the Federal Reserve Board, by the affirmative vote of not less than five members, may authorize any Federal reserve bank, during such periods as the said board may determine, at rates established in accordance with the provisions of section 14, subdivision (d), of this Act, to discount for any individual, partnership, or corporation, notes, drafts, and bills of exchange of the kinds and maturities made eligible for discount for member banks under other provisions of this Act when such notes, drafts, and bills of exchange are indorsed and otherwise secured to the satisfaction of the Federal reserve bank: Provided, That before discounting any such note, draft, or bill of exchange for an individual or a partnership or corporation the Federal reserve bank shall obtain evidence that such individual, partnership, or corporation is unable to secure adequate credit accommodations from other banking institutions. All such discounts for individuals, partnerships, or corporations shall be subject to such limitations, restrictions, and regulations as the Federal Reserve Board may prescribe."

In view of the fact that the power conferred by this provision can be exercised only in "unusual and exigent circumstances", the Federal Reserve Board has not prescribed any formal regulations governing the exercise of this power; but the requirements of the law and the procedure which the Federal Reserve Board will expect to be followed are outlined below for the information of the Federal reserve banks and any individuals, partnerships or corporations that may contemplate applying to them for discounts.

I. LEGAL REQUIREMENTS.

It will be observed that, by the express terms of the law:

1. The power conferred upon the Federal Reserve Board to authorize Federal reserve banks to discount eligible paper for individuals, partnerships or corporations may be exercised only:
 - (a) In unusual and exigent circumstances,
 - (b) By the affirmative vote of not less than five members of the Federal Reserve Board, and
 - (c) For such periods as the Federal Reserve Board may determine.
2. When so authorized, a Federal Reserve Bank may discount for individuals, partnerships or corporations only notes, drafts and bills of exchange of the kinds and maturities made eligible for discount for member banks, under other provisions (Sections 13 and 13a) of the Federal Reserve Act. (Such paper must, therefore, comply with the applicable requirements of Regulation A of the Federal Reserve Board).
3. Paper discounted for individuals, partnerships or corporations must be both (a) indorsed and (b) otherwise secured to the satisfaction of the Federal reserve bank.
4. Before discounting paper for any individual, partnership or corporation, a Federal reserve bank must obtain evidence that such individual, partnership or corporation is unable to secure adequate credit accommodations from other banking institutions.
5. Such discounts may be made only at rates established by the Federal reserve banks, subject to review and determination by the Federal Reserve Board.
6. All discounts for individuals, partnerships or corporations are subject to such limitations, restrictions, and regulations as the Federal Reserve Board may prescribe.

II. AUTHORIZATION BY THE FEDERAL RESERVE BOARD.

The Federal Reserve Board, pursuant to the power conferred upon it by the amendment hereinbefore quoted, hereby authorizes all Federal reserve banks, for a period of six months beginning August 1, 1932, to discount eligible notes, drafts and bills of exchange for individuals, partnerships and corporations, subject to the provisions of the law, the Board's regulations, and this circular.

III. FOR WHOM PAPER MAY BE DISCOUNTED.

A Federal reserve bank may discount for individuals, partnerships or corporations notes, drafts or bills of exchange, which are the obligations of other parties actually owned by such individuals, partnerships or corporations and indorsed by them, or the promissory notes of such individuals, partnerships, or corporations indorsed by other parties whose indorsements are satisfactory to the Federal reserve bank.

Within the meaning of this circular, the term "corporations" does not include banks.

IV. APPLICATIONS FOR DISCOUNT.

Each application of an individual, partnership or corporation for the discount of eligible paper by the Federal reserve bank must be addressed to the Federal Reserve Bank of the District in which the principal place of business of the applicant is located, must be made in writing on a form furnished for that purpose by the Federal reserve bank and must contain, or be accompanied by, the following:

1. A statement of the circumstances giving rise to the application and of the purposes for which the proceeds of the discount are to be used;
2. Evidence sufficient to satisfy the Federal reserve bank as to (a) the legal eligibility of the paper offered for discount under Section 13 or Section 13(a) of the Federal Reserve Act and Regulation A of the Federal Reserve Board and (b) its acceptability from a credit standpoint;
3. A statement of the efforts made by the applicant to obtain adequate credit accommodations from other banking institutions, including the names and addresses of all other banking institutions to which applications for such credit accommodations were made, the dates upon which such applications were made, whether such applications were definitely refused and the reasons, if any, given for such refusal;
4. A list showing each bank with which the applicant has had banking relations, either as a depositor or as a borrower, during the preceding year, with the approximate date upon which such banking relations commenced and, if such banking relations have been terminated, the approximate date of their termination;
5. Complete credit data regarding the financial condition of the principal obligors and indorsers on the paper offered for discount;
6. A list and description of the collateral or other security offered by the applicant;
7. A waiver by the applicant of demand, notice and protest as to applicant's obligation on all paper discounted by the Federal reserve bank or held by the Federal reserve bank as security; and
8. An agreement by the applicant, in form satisfactory to the Federal reserve bank, (a) to furnish additional credit information to the Federal reserve bank, when requested, (b) to submit to audits, credit investigations or examinations by representatives of the Federal reserve bank at the expense of the applicant, whenever requested by the Federal reserve bank, and (c) to furnish additional security whenever requested to do so by the Federal Reserve Bank.

V. GRANT OR REFUSAL OF APPLICATION.

Before discounting notes, drafts, or bills of exchange for any individual, partnership or corporation, the Federal reserve bank shall ascertain to its satisfaction by such means as it may deem appropriate:

1. That the financial condition and credit standing of the applicant justify the granting of such credit accommodations;
2. That the paper offered for discount is acceptable from a credit standpoint and eligible from a legal standpoint;
3. That the security offered is adequate to protect the Federal reserve bank against loss;
4. That there is a reasonable need for such credit accommodations; and
5. That the applicant is unable to obtain adequate credit accommodations from other banking institutions.

A special effort should be made to determine whether the banking institution with which the applicant ordinarily transacts his banking business or any other banking institution to which the applicant ordinarily would have access is willing to grant such credit accommodations.

A Federal reserve bank should not discount such paper unless it appears that the proceeds of such discounts will be used to finance current business operations and not for speculative purposes, for permanent or fixed investments, or for any other capital purposes. Except with the permission of the Federal Reserve Board, no such paper should be discounted if it appears that the proceeds will be used for the purpose of paying off existing indebtedness to other banking institutions.

In discounting paper for individuals, partnerships or corporations, a Federal reserve bank should not make any commitment to renew or extend such paper or to grant further or additional discounts.

VI. LIMITATIONS.

Except with the permission of the Federal Reserve Board, no Federal reserve bank shall discount for any one individual, partnership or corporation paper amounting in the aggregate to more than one per cent of the paid-in capital stock and surplus of such Federal reserve bank.

VII. ADDITIONAL REQUIREMENTS.

Any Federal reserve bank may prescribe such additional requirements and procedure respecting discounts hereunder as it may deem necessary or advisable; provided that such requirements and procedure are consistent with the provisions of the law, the Board's regulations and the terms of this circular.

By order of the Federal Reserve Board.

CHESTER MORRILL,
Secretary.

Extracts from Regulation A, Series of 1930, of the Federal Reserve Board

Defining paper eligible for discount by a Federal Reserve Bank

Section I. General Statutory Provisions

Any Federal Reserve Bank may discount for any of its member banks any note, draft, or bill of exchange: *Provided*—

(a) It has a definite maturity at the time of discount of not more than 90 days, exclusive of days of grace; except that (1) if drawn or issued for an agricultural purpose or based on livestock, it may have a maturity at the time of discount of not more than nine months, exclusive of days of grace, and (2) certain bills of exchange payable at sight or on demand are eligible even though they have no definite maturity * * * * *

Section II. General Character of Notes, Drafts, and Bills of Exchange Eligible

The Federal Reserve Board, exercising its statutory right to define the character of a note, draft, or bill of exchange eligible for discount at a Federal Reserve Bank has determined that—

(a) It must be a negotiable note, draft, or bill of exchange which has been issued or drawn, or the proceeds of which have been used or are to be used in the first instance, in producing, purchasing, carrying, or marketing goods in one or more of the steps of the process of production, manufacture, or distribution, or for the purpose of carrying or trading in obligations of the Government of the United States, and the name of a party to such transaction must appear upon it as maker, drawer, acceptor, or indorser.

(b) It must not be a note, draft, or bill of exchange the proceeds of which have been or are to be advanced or loaned to some other borrower, except as to paper described below under Sections VI (b) and VIII.

(c) It must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for permanent or fixed investments of any kind, such as land, buildings, or machinery, or for any other capital purpose.

(d) It must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for investments of a purely speculative character.

(e) It may be secured by the pledge of goods or collateral of any nature, including paper which is ineligible for discount, provided it (the note, draft, or bill of exchange) is otherwise eligible.

NOTE: *When used in this regulation the word "goods" shall be construed to include goods, wares, merchandise, or agricultural products, including livestock.*